

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

**BRIEF FOR PETITIONER AND
JOINT APPENDIX**

IN THE
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA ~~CIRCUIT~~

*United States Court of Appeals
For the
District of Columbia Circuit*

No. 10,983 FILED MAY 3 1951

M. E. S. BRUNELLE, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

**On Petition for Review of the Decision of
The Tax Court of the United States.**

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STATEMENT OF THE QUESTION PRESENTED.

When Congress appropriates additional funds to meet increased living expenses of Government employees stationed in Alaska, which additional funds would not be paid if the employee returned to the United States, are these additional amounts taxable even though the Internal Revenue Code exempts from income tax amounts paid to Government employees as a cost-of-living allowance?

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BRIEF FOR PETITIONER.

JURISDICTIONAL STATEMENT.

On June 23, 1948, the Commissioner of Internal Revenue sent by registered mail to the petitioner in Alaska two deficiency notices asserting additional Federal income taxes to be due for the years 1945 and 1946 in the respective amounts of \$305.37 and \$316.92 (R. 6-15). On October 25, 1948, within the 150 day period allowed by § 272(a)(1) of

the Internal Revenue Code, petitioner filed a petition in The Tax Court of the United States, appealing from these deficiency notices (App. 3-4).¹

The Tax Court on November 30, 1950, promulgated its findings of fact and opinion which were reviewed by the Court and are reported at 15 T. C. No. 100 (App. 19-25), and on December 5, 1950, the Tax Court entered its decision in which it sustained the determination of the respondent (App. 26).

On March 2, 1951, pursuant to the provisions of §§ 1141 and 1142 of the Internal Revenue Code, petitioner filed with the Tax Court a petition for review by this Court of the findings of fact, opinion, and decision of the Tax Court (R. 77-79). The parties have stipulated venue in this Court pursuant to the provisions of § 1141(b)(2) of the Internal Revenue Code (R. 76).

STATEMENT OF THE CASE.

The petitioner is an individual residing at Anchorage, Territory of Alaska. Throughout the calendar years 1945 and 1946, petitioner was an employee of the Government of the United States stationed in Alaska and was serving as Clerk of the United States District Court for the Territory of Alaska, Third Division. The returns for the periods here involved were filed with the collector of internal revenue for the district of Washington (App. 20).

Pursuant to Executive Order No. 8955 issued December 1, 1941 (6 F. R. 6201), the War and Navy Departments were authorized to pay certain of their civilian employees stationed outside the United States an additional amount not to exceed 25 per cent of their base pay. Following a ruling by the Comptroller General on this subject, the Civil Service Commission collaborated with various agencies of the Government in the preparation of a policy agreement for the purpose of assuring that all Government em-

¹ References preceded by "App." are to the Joint Appendix; those preceded by "R" are to the certified transcript of record.

ployees in the same geographic area would secure uniform treatment (App. 15; R. 61, 66). This agreement which is known as Departmental Circular No. 394, Supplement No. 2, was circularized on January 16, 1943, and fixed a "uniform salary differential of 25 per cent of the employee's base salary" to be applicable in the territories of the United States and to be effective March 15, 1943 (App. 17; R. 65-66).

On February 2, 1943, a copy of this policy agreement was sent to the President by the Civil Service Commission (App. 15, 17). In transmitting this agreement, the Commission stated that in view of its provisions, there was no further need for Executive Order No. 8955, and the Commission recommended that the Executive Order be revoked (App. 16). On March 15, 1943, the effective date of the policy agreement, the President issued Executive Order No. 9314 (8 F. R. 3279) which provided in part as follows (App. 15):

* * * upon recommendation of the Civil Service Commission, and finding that such action is necessary to the more efficient operation of the Government, it is ordered as follows:

1. Executive Order No. 8955 of December 1, 1941, extending the Classification Act of 1923, as amended, to certain positions in the War Department and in the Navy Department and establishing a salary differential therefor, is hereby revoked.

2. This order shall take effect as of March 15, 1943.

The Administrative Office of the United States Courts (which is in charge of the personnel and budgetary matters for the Federal courts) apparently was not a party to this policy agreement (App. 8, 13), but it desired that the territorial employees of the Federal courts should receive the same financial consideration as did other employees of the Government (Hearings before the Subcommittee of the Committee on Appropriations, House of Representatives, 78th Cong., 2d Sess., on the Judiciary Ap-

propriation Bill for 1945, pp. 67-69).² Accordingly, the Administrative Office of the United States Courts asked Congress to increase its appropriation so that it could pay the court employees outside the United States an additional 25 per cent (App. 8-10).

In doing so Mr. Henry P. Chandler, Director of the Administrative Office of the United States Courts, explained the situation to the Subcommittee in part as follows (Hearings, pp. 67-68):

Mr. O'Neal: The next item of increase is salary differential for higher living costs, \$2,970.

Mr. Chandler: That enters into two or three appropriation items. This is the one in which it first arises.

The Civil Service Commission, with various agencies of the Government, gave prolonged consideration last year to the question whether or not there should be a differential in salaries of Government agencies in the Territories of Hawaii, Alaska, Puerto Rico, and the Virgin Islands. There had been previously a differential established for the Canal Zone, which had a different status from the other territories. But it was urged that the cost of living was very high, indeed, in these other territories.

I have a general letter here issued by Mr. Moyer, the executive director and chief examiner of the United States Civil Service Commission, dated January 16, 1943, in which he stated that various departments which are the principal Federal employing agencies, and a large majority of the agencies having any employees in the territories and insular possessions, compensated under the Classification Act, are joining in a cooperative move to establish and follow a Government-wide policy in this important matter, that for all practical purposes, such agencies should consider the stated policy as now being in effect. The stated policy is set up in a policy agreement which appears on the reverse side of the letter, and which indicates as the

² These hearings were offered in evidence by petitioner but the court below declined to receive them since they covered matters of which the court would take judicial notice (App. 7, 19.)

primary feature that a uniform salary differential of 25 per cent of the employee's base salary is adopted and will be applied under the conditions and in the manner outlined in the agreement.

Now, in Hawaii, Alaska, Puerto Rico, I am informed that most of the executive agencies have complied with this plan. I was asked to authorize this differential for the employees of the courts. I stated that there was no provision in the appropriation for such a differential, but I thought that money could be saved through lapses and in other ways to provide a smaller differential for 1944.

Mr. O'Neal: In other words, you have not put this into effect?

Mr. Chandler: The 25 per cent; no.

Mr. O'Neal: The 25 per cent, and you are asking for it in your request for 1945?

Mr. Chandler: I am asking for it.

Mr. O'Neal: Are you asking for it all the way through?

Mr. Chandler: I am asking for it in all of the salary appropriations to which it applies. It will come up in the appropriation for clerks' salaries. I do not believe it enters into the appropriation for miscellaneous salaries.

* * * * *

Mr. Chandler: * * * I should say that if there are available funds it would be within my power in fixing the compensation of employees paid out of the appropriation to allow a differential for the employees outside of the continental United States. I thought it was and considered that in view of the conditions in, for instance, Anchorage, Alaska, where the cost of living is really comparable to what it was in California in the days of the gold rush, and also as it is represented in Puerto Rico and in Hawaii, fairness required such action; consequently I authorized a 10 per cent differential for this current year.

Mr. O'Neal: In other words, these salaries are not fixed by law and there is nothing to prevent you from doing what you have done?

Mr. Chandler: No. But, of course, I must keep within the appropriation. Within that, it is a matter of my judgment. * * *

The matter was referred to again in the same hearing as follows (Hearings, pp. 76-79):

Mr. O'Neal: The increases asked in your estimate for 1945 are, (1) an increase in compensation in lieu of overtime pay, \$388,500; (2) the difference between part-year and full-year cost of within grade salary increases authorized in 1944, \$17,490; (3) reclassification of positions of deputy clerks, \$18,000; (4) reclassification of positions of librarians, \$4,520; additional temporary employees in the field, \$10,000; and salary differential for higher living costs outside the United States, \$14,920.

Will you take up those items and discuss them very briefly?

* * * * *

Mr. O'Neal: How many people are involved in your salary differential for higher living cost outside the United States?

Mr. Jackson: That will provide a differential for a total of 22 employees. There will be 6 in the Territory of Alaska, 4 in Hawaii, 7 in Puerto Rico, and 5 in the Virgin Islands.

The position held by the petitioner was one of the six Alaskan positions just referred to (App. 8).

The entire amount of the additional appropriation requested as aforesaid by the Administrative Office of the United States Courts as "salary differential for higher living costs outside the United States" was \$14,920.00, and this amount was incorporated in the appropriation for salaries of clerks of courts made by Congress in the Judiciary Appropriation Act, 1945, c. 277, 58 Stat. 334, 356 (Public Law No. 354, 78th Cong., 2d Sess.), in the amount of \$2,985,000.00 (App. 8-10).

Following the signing by the President of the Judiciary Appropriation Act, 1945, petitioner was notified in writing by the Administrative Office of the United States Courts in part as follows (App. 10, 20-21; R. 67):

The Appropriation Act for the fiscal year 1945 includes funds for the purpose of granting a 25 per cent

increase in the basic salary of the clerks and deputy clerks in offices outside the continental United States as a differential for increased living costs. We are, therefore, glad to authorize the increase in your salary effective July 1, 1944, as follows:

Name	Basic Salary	Differ- ential	Additional Compensation Pursuant to War Overtime Pay Act of 1943	Total
M. E. S. Brunelle	\$4,400	\$1,100	\$435	\$5,935

This letter or a copy thereof filed with the United States marshal will be his authority to pay the compensation as above set forth from the appropriation "Salaries of Clerks, United States Courts."

The differential for increased cost of living above specified shall terminate on such date as the Director of the Administrative Office of the United States [Courts] may prescribe.

In the Judiciary Appropriation Act, 1946, c. 129, 59 Stat. 169, 198, and the Judiciary Appropriation Act, 1947, c. 541, 60 Stat. 446, 477, Congress continued an appropriation for this additional payment of 25 per cent (App. 12). Pursuant to these statutes and the letter of authorization referred to above, petitioner received additional payments of 25 per cent of his basic salary by years and in the respective amounts as follows (App. 10-11, 21; R. 20-21):

Calendar Year	Additional Payment
1945	\$1,182.59
1946	\$1,385.65

These amounts were paid from the \$14,920.00 appropriated as aforesaid and from a similar item in the succeeding Appropriation Acts (App. 10-12).

In authorizing this additional payment of 25 per cent, the Administrative Office of the United States Courts

adopted and followed the percentage that had been agreed upon in the policy agreement sponsored by the Civil Service Commission and referred to above (App. 11-12).

The cost of living in Alaska in 1945 and 1946 was not less than 40 per cent higher than the cost of living in the United States in those years (App. 21). The Territory of Alaska is "outside continental United States" as that phrase is used in § 116(j) of the Internal Revenue Code (App. 20). In preparing his 1945 and 1946 Federal income tax returns, petitioner did not treat as taxable income the respective amounts of \$1,182.59 and \$1,385.65 (App. 22).

If petitioner had been transferred to a post within any state of the United States or the District of Columbia at any time during 1945 or 1946, he would not have been entitled to receive any portion of the respective amounts of \$1,182.59 and \$1,385.65 attributable to any portion of the calendar year subsequent to the effective date of his transfer (App. 21).

STATUTE INVOLVED.

The statute involved is § 116(j) of the Internal Revenue Code which provides:

SEC. 116. EXCLUSIONS FROM GROSS INCOME.

In addition to the items specified in section 22(b), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * *

(j) In the case of a clerk or employee in the Foreign Service of the United States, amounts received as cost-of-living allowances under authority of section 3, as amended, of the Act of February 23, 1931; and in the case of an ambassador, minister, diplomatic, consular, or Foreign Service officer, amounts received as post allowances under the authority of section 12, as amended and renumbered, of the Act of May 24, 1924; and in the case of other civilian officers or employees of the Government of the United States stationed out-

side continental United States, amounts received as cost-of-living allowances in accordance with regulations approved by the President.

The language of subsection (j) was added to the Internal Revenue Code by § 125(a) of the Revenue Act of 1943, c. 63, 58 Stat. 21, 46; U. S. C., Title 26, § 116(j).

STATEMENT OF POINTS.

1. The Tax Court erroneously failed to find and hold that the amounts here involved were paid to the petitioner as cost-of-living allowances.

2. The Tax Court erroneously failed to hold that the amounts here involved were excludible from gross income and exempt from tax under § 116(j) of the Internal Revenue Code.

SUMMARY OF ARGUMENT.

For years the Government has been asserting that in tax cases the substance of a transaction should control over its form. Here the cost of living in Alaska was admittedly 40 per cent higher than in the United States, Congress was asked to and did appropriate additional funds to compensate for these higher living costs, and the additional funds would not be paid if the employee returned to the United States. The same Congress had previously provided that amounts paid as "cost-of-living allowances" should be excluded from gross income and be exempt from tax.

Petitioner submits that the substance versus form rule should apply when it favors the taxpayer as well as when it favors the Government; that there is no distinction of substance between amounts paid to meet "higher living costs" and amounts paid as "cost-of-living allowances"; and that the purpose of the additional appropriation is controlling and not the fact that it was technically included in a subdivision of an appropriation act bearing the general heading of "Salaries".

Section 116(j) is a relief provision and should be construed to afford the relief it was intended to provide. Moreover, the purpose of the statute should not be thwarted by an incomplete legislative history of the section.

ARGUMENT.

1. **The Tax Court erroneously failed to find and hold that the amounts here involved were paid to the petitioner as cost-of-living allowances.**

The ultimate question for decision is whether the amounts of \$1,182.59 and \$1,385.65 received by petitioner in 1945 and 1946, respectively, are excludible from his gross income and exempt from tax under § 116(j) of the Internal Revenue Code. This statute exempts from Federal income taxation:

* * * In the case of * * * civilian officers or employees of the Government of the United States stationed outside continental United States, amounts received as cost-of-living allowances in accordance with regulations approved by the President.

It is agreed that petitioner was a civilian employee of the Government stationed in Alaska and that Alaska is outside continental United States as that phrase is used in § 116(j) of the Code (App. 20).

At the outset it should be noted that in 1945 and 1946 the cost of living in Alaska was not less than 40 per cent higher than in the United States (App. 21). In fact, in Anchorage where the petitioner lives, the condition was described to Congress as—

* * * really comparable to what it was in California in the days of the gold rush * * * (Hearings, p. 68; cf. pp. 134-135—referred to supra, p. 3).

In view of this hardship an additional appropriation to meet these "higher living costs" was requested from Congress on behalf of the court employees (Hearings, pp. 67-69, 76, 79).

In granting the additional appropriation, Congress clearly understood that the money was being appropriated because of the higher living costs prevailing in Alaska and the other Territories. Thus, the committee reports of both Houses referred to this additional appropriation as a “* * * salary differential for higher living costs * * *” outside the United States (House Report No. 1259, 78th Cong., 2d Sess., p. 9; Senate Report No. 888, 78th Cong., 2d Sess., p. 3).³

The amounts here involved were paid to the petitioner from this additional appropriation and solely because of his higher living costs due to the fact that he was stationed outside the continental United States (App. 10-12). It was an “allowance” to meet his increased living costs in Alaska. Any doubt in the matter is dispelled by the fact that the petitioner would immediately have lost the benefit of this additional 25 per cent if he had been transferred to a post within the United States (App. 21).

It is no answer to say, as did the Tax Court (App. 25), that the amounts here involved were “merely salary increases.” A salary is a contractual payment in contradistinction to a discretionary gift. As was said in *Benedict v. United States*, 176 U. S. 357, 360:

The word “salary” may be defined generally as a fixed annual or periodical payment for services, depending upon the time and not upon the amount of services rendered.

On the other hand, as was held in *Mangum v. City of Brooklyn*, 98 N. Y. 585, 596, 50 Am. Rep. 705:

The word “allowance” imports the voluntary act of one party in doing something which is in his discretion to perform or withhold at pleasure.

³ Since the small amounts here involved appear in the statute as part of an appropriation for various salaries in a total amount of \$2,895,000 (App. A 10), it is believed to be clear that the legislative history of the act may be considered to show the breakdown of this lump sum item. 2 Sutherland, *Statutory Construction* (3rd ed., 1943), § 5002.

See also *Blaine County v. Pyrah*, 32 Idaho 111, 178 P. 702, 703, and *Brandon v. Askew*, 172 Ala. 160, 54 So. 605, 608. Furthermore, the authorization to pay this additional amount clearly separated it from his salary (App. 20-21).

Since the Government reserved the right to discontinue at any time the 25 per cent here involved, and since it would automatically be discontinued in the event petitioner returned to the States (App. 21), petitioner submits that these amounts were clearly "allowances" instead of "salary" within the general meaning of these words.

The additional payments made to petitioner to compensate him for additional living costs which he incurred in Alaska were roughly \$1,200 in each of the years involved (App. 21) and the additional tax is roughly \$300 in each year (App. 20). To the extent of the tax imposed upon petitioner, he is being denied approximately one-fourth of the money which Congress has allowed petitioner for the purpose of defraying his increased living costs.

It is hard to believe that the 78th Congress which provided that "cost-of-living allowances" independent of any salary increases should be exempt from tax and then later appropriated funds to defray the "higher living costs" of Alaskan employees, really intended to recapture through taxes approximately one-fourth of the amounts which it had allowed employees for higher living costs.

One other thought should be discussed under this point. As mentioned by the Tax Court (App. 22), the original determination made by the respondent in this case was based on his ruling in G. C. M. 24,162 (1944 Cum. Bull. 266). A major premise in this ruling, and also of I.T. 3807 (1946-2 Cum. Bull. 67), was that the Comptroller General had held that the additional 25 per cent paid to Government employees as in the case at bar was "basic compensation." Under substantially similar language in a later Act and in the light of Executive Order 10,000 (13 F. R. 5453) the Comptroller General appears to have changed his position and now holds that this additional 25 per cent is not to be considered as compensation for purposes of computing

“overtime, holiday pay, and retirement deductions.” 28 Comp. Gen. 266, 268-269. Since this vital premise of the Treasury Rulings no longer exists, it is submitted that no weight should be given them. Moreover, it is well established that office rulings by the respondent—

* * * cannot narrow the scope of a statute when Congress plainly has intended otherwise.

Neuberger v. Commissioner, 311 U. S. 83, 89; *Epley v. Commissioner*, 5 Cir., 183 F. 2d 1020, 1022.

Petitioner was paid a basic salary for his services as a District Court clerk. If he received an additional amount for performing the same duties in Alaska as compared with the United States—which additional amount would not be paid if he were transferred to the United States—the substance of the matter is that he received an extra allowance to meet his higher living costs in Alaska.

For years the Government has been arguing that, in deciding tax questions, substance should prevail over form.⁴ It is submitted that the rule should not be turned on or off as best suits the needs of the tax gatherer.

2. The Tax Court erroneously failed to hold that the amounts here involved were excludible from gross income and exempt from tax under § 116(j) of the Internal Revenue Code.

In construing § 116(j) it should be noted that the entire subsection deals with three classes of payments to Government employees. They are:

1. Cost-of-living allowances paid to Foreign Service employees under a 1931 Act.
2. Post allowances paid to diplomatic officials under a 1924 Act.

⁴ *Helvering v. Tex-Penn Oil Co.*, 300 U. S. 481, 492-493; *Whitehead v. Commissioner*, 4 Cir., 148 F. 2d 718, 720; *Lehman v. Commissioner*, 2 Cir., 109 F. 2d 99, 100, certiorari denied 310 U. S. 637.

3. Cost-of-living allowances received by other Government employees stationed outside the United States in accordance with regulations approved by the President.

We are concerned only with the last classification.⁵

The legislative history referred to by the Tax Court (App. 23-24), however, deals only with the first two classifications. Thus, the Senate Report No. 627 (App. 23) deals (1) with personnel stationed in foreign countries and (2) with the post allowances of diplomats. If the quotation from the Senate Report covers the whole scope of § 116(j), then obviously there is no need for the last part of the statute dealing with "other civilian officers or employees." The only reasonable explanation of the discrepancy is that originally § 116(j) was intended to cover only personnel in foreign countries and post allowances and that the draft of the amendment read this way when the first part of the Senate Report was prepared and that thereafter the draft of the section was amended by the addition of the provision here involved. Such a change necessarily presupposes that Congress intended the last portion of § 116(j) to have a much broader scope than the parts referred to in the Senate Report. Certainly the use of such expansive phrases as "*other civilian officers and employees*" and "*amounts received as cost-of-living allowances*" (italics supplied) does not suggest the restrictive interpretation applied by the Tax Court.

Petitioner contends that the third subdivision of § 116 (j) is clear and that the statute should be construed so as to give effect to all of its parts. *McDonald v. Thompson*, 305 U. S. 263, 266; 2 Sutherland, Statutory Construction (3rd ed. 1943), § 4705. There appears to be no legislative

⁵ That three distinct categories of § 116 (j) relief were intended by Congress is shown by Senate Report No. 627, 78th Cong., 1st Sess., p. 56 (1944 Cum. Bull. 973, 1014) and by the report of the Committee of Conference, House Report No. 1079, 78th Cong., 2nd Sess., p. 51 (1944 Cum. Bull. 1059, 1067).

history discussing the third subdivision of § 116 (j). Accordingly, petitioner submits that the obvious intent of the third subdivision of the statute should not be ignored by reference to the sketchy history of its other parts. As was said in *Ex Parte Collett*, 337 U. S. 55, 61:

* * * there is no need to refer to the legislative history where the statutory language is clear. "The plain words and meaning of a statute cannot be overcome by a legislative history which, through strained processes of deduction from events of wholly ambiguous significance, may furnish dubious bases for inference in every direction." *Gemsco, Inc. v. Walling*, 324 U. S. 244, 260 (1945). This canon of construction has received consistent adherence in our decisions. * * *

Other authorities on this proposition are collected in *United States v. Missouri Pac. R. Co.*, 278 U. S. 269, 278.

The last point made by the Tax Court is that (App. 25):

The petitioner has been unable to point to any regulation approved by the President which in any way relates to the payments here in question.

Since the President signed the Appropriation Acts which authorized this additional payment of 25 per cent, and since a statute takes precedence over a regulation, petitioner submits that this last requirement was met when the Appropriation Acts became law. The President obviously approved the payment of this 25 per cent and the record shows that the payments were made in accordance with the statute (App. 10-12).

Petitioner also submits that this last requirement is met by the evidence here and Executive Order No. 9314. Certainly, the Presidential revocation of his prior Executive Order can only be construed as an approval of the policy agreement known as the Civil Service Commission's Department Circular No. 394, Supplement No. 2 (App. 15-16; R. 65-66) which was considered to be a Civil Service Regulation by the Comptroller General (23 Comp. Gen. 319, 322).

A copy of this policy agreement was received by the Administrative Office of the United States Courts and formed a part of its basis for requesting the additional appropriation here involved (Hearings, p. 67; App. 11; R. 61-66). While the Administrative Office of the United States Courts apparently did not sign this policy agreement (App. 8, 13), it did adopt the provisions of the policy agreement and it followed these provisions in making the payments here in question (App. 11-12). Thus, the payments were *in accordance with* the Civil Service Circular (or Regulation) which was approved by the President.

Finally, it should be remembered that § 116 (j) is a relief provision and as such should be liberally construed so as to afford the relief it was intended to provide. *Bonwit Teller & Co. v. United States*, 283 U. S. 258, 263; *Gooch Milling & Elevator Co. v. United States*, 111 C. Cls. 576, 587, 78 F. Supp. 94, 100; and *National Butane Gas Co.*, 11 T. C. 593, 598.

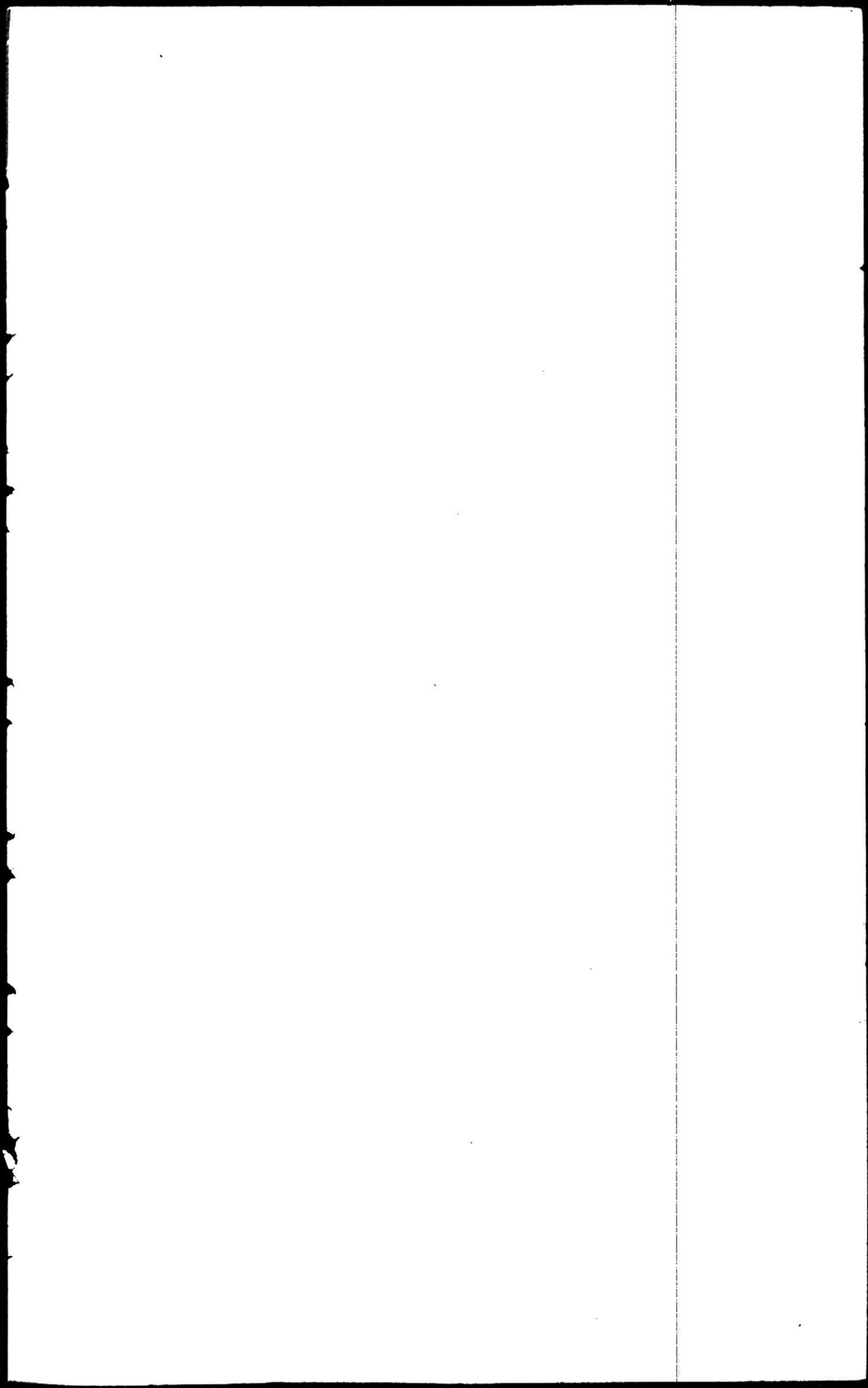
CONCLUSION.

Congress allowed petitioner an additional sum of money to help defray his increased living costs in Alaska and the payment of this additional amount was approved by the President. Under § 116 (j) this cost-of-living allowance is exempt from tax.

Respectfully submitted,

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APPENDIX

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IN THE
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FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 10,983.

M. E. S. BRUNELLE, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Review of Decision of The Tax Court
of the United States.

JOINT APPENDIX.

**PLEADINGS, DOCKET ENTRIES AND
OTHER PAPERS.**

1

Docket No. 20780

M. E. S. BRUNELLE, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Appearances:

For Petitioner: Geo. E. H. Goodner, Esq., Scott P.
Crampton, Esq.

For Respondent: Sanford M. Stoddard, Esq.

Transferred to Judge Murdock Dec. 9, 1949

Docket Entries.

1948

Oct 25—Petition received and filed. Taxpayer notified.
Fee paid.

Oct 26—Copy of petition served on General Counsel.

Oct 25—Request for Circuit hearing in Washington, D. C.
filed by taxpayer. 11/17/48 Granted.

Dec 7—Answer filed by General Counsel.

Dec 10—Copy of answer served on taxpayer—Washing-
ton, D. C. calendar.

1949

Mar 29—Hearing set May 23, 1949—Washington, D. C.
calendar.

May 9—Motion for leave to file amended answer, amended
answer lodged, filed by General Counsel. 5/10/49.
Motion Granted and Amended answer filed.

May 24—Hearing had before Judge Harlan on merits.
Stipulation of facts filed. Petitioner's brief due
7/8/49. Respondent's brief 8/8/49. Reply briefs
due 8/23/49.

Jun 3—Transcript of hearing 5/24/49 filed.

Jul 8—Brief filed by taxpayer. 7/21/49 Copy served.
 Aug 22—Brief filed by General Counsel. Copy served.
 Sep 2—Reply brief filed by taxpayer. 9/6/49 Copy served.

1950

Nov 30—Findings of fact and opinion rendered, Judge Murdock. Decision will be entered for respondent. Copy served.

Dec 5—Decision entered. Judge Kern. Div. 16.

1951

Mar 2—Petition for review by U. S. Court of Appeals, District of Columbia, filed by taxpayer.

Mar 2—Stipulation of Venue filed.

Mar 6—Proof of service of petition for review filed.

Mar 20—Stipulation re Record on appeal, filed.

2

Filed Oct 25 1948

Petition.

The above-named petitioner hereby petitions for a re-determination of the deficiencies set forth by the Commissioner of Internal Revenue in his two notices of deficiency (Bureau Symbols: IT:KCH:te 7294434-47 and IT:KCH:te 7223313-46) each dated June 23, 1948, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual residing at Anchorage, Territory of Alaska. The returns for the periods here involved were filed with the collector of internal revenue for the district of Washington.

2. The two notices of deficiency were each mailed to petitioner on June 23, 1948. The notice of deficiency for the calendar year 1945 is attached hereto and marked Exhibit A. The notice of deficiency for the calendar year 1946 is attached hereto and marked Exhibit B.

3. The taxes in controversy are income taxes for the calendar years 1945 and 1946 and are in the respective amounts of \$305.37 and \$316.92.

4. The determinations of tax set forth in the said notices of deficiency are based upon the following error:

(a) In determining the gross income of the petitioner for the calendar years 1945 and 1946, respondent has erroneously included therein the amounts of \$1,182.59 and \$1,385.65 representing cost-of-living allowances paid to petitioner as an employee of the Government located outside continental United States.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Throughout the calendar years 1945 and 1946 petitioner was an employee of the Government of the United States stationed in Alaska and was serving as the Clerk of the United States District Court for the Territory of Alaska, Third Division. His basic pay for services as such Clerk was in the approximate amounts of \$4,730.36 and \$5,542.60 for the years 1945 and 1946, respectively.

(b) The Territory of Alaska is "outside continental United States" as that phrase is used in Section 116(j) of the Internal Revenue Code.

(c) In 1945 and 1946 petitioner received, in addition to his basic pay, the respective amounts of \$1,182.59 and \$1,385.65 representing cost-of-living allowances. These cost-of-living allowances were paid to petitioner from funds appropriated by Congress for this specific purpose and because of the fact that petitioner was stationed outside continental United States. Such cost-of-living allowances are exempt from tax under the provisions of Section 116(j) of the Internal Revenue Code.

WHEREFORE, the petitioner prays that this Court may hear the proceeding and find and hold that petitioner is not taxable in 1945 and 1946 on the aforesaid cost-of-living allowances received by him in the years involved.

[Signed] SCOTT P. CRAMPTON

SCOTT P. CRAMPTON,
Munsey Building,
Washington 4, D. C.,
Attorney for Petitioner.

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Filed May 10 1949

Amended Answer to Petition.

Now comes the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for amended answer to the petition filed herein, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4(a). Denies that respondent erred in determining the deficiencies as set forth in the statutory notices which are attached to the petition, and specifically denies that the respondent erred as alleged in subparagraph (a) of paragraph 4 of the petition.

5(a). Admits that throughout the calendar years 1945 and 1946 petitioner was an employee of the Government of the United States stationed in Alaska and was serving as Clerk of the United States District Court for the Territory of Alaska, Third Division. Denies the remaining
19 allegations of subparagraph (a) of paragraph 5 of the petition.

5(b). Admits the allegations contained in subparagraph (b) of paragraph 5 of the petition.

5(c). Admits that in the years 1945 and 1946 petitioner received the respective amounts of \$1,182.59 and \$1,385.65 out of funds appropriated by Congress. Denies the remaining allegations of subparagraph (c) of paragraph 5 of the petition.

WHEREFORE, it is prayed that the petitioner's appeal be denied and that the Commissioner's determination be approved.

(Signed) CHARLES OLIPHANT,
PAB

CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

PHILIP A. BAYER,
Division Counsel.

SANFORD M. STODDARD,
Special Attorney
Bureau of Internal Revenue.

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EXCERPTS FROM TESTIMONY AND PROCEEDINGS.

29 Mr. Crampton: I offer as Exhibit number 2 the 1946 tax return filed by the petitioner and also, as Exhibit number 3 the Civil Service Commission's circular number 394, as originally promulgated and supplement number 1 and supplement number 2 and ask that it be received as one exhibit.

It is a certified copy.

30 Mr. Stoddard: Your Honor, I have one objection to this and that is on the ground of its materiality. I think it will be first necessary to show in what respects this departmental circular is material to any issue in this case.

The Court: That of course will be something that will be an issue in the briefs. That goes right to the heart of your question pretty much, does it not.

Mr. Stoddard: This departmental circular is something issued by the Civil Service Commission; and has no reference in it at any place to the payments here in issue. It has reference to certain payments made by other government agencies.

The Court: What I have in mind doing, inasmuch as the authenticity or correctness of it is not questioned, we will accept the exhibit now and if it has no relevancy to the issues, why it is very easily determined at the time of the hearing.

Let the exhibits be received.

(The documents referred to were marked respectively, Petitioner's Exhibits 2 and 3, and received.)

Mr. Crampton: At this time, your Honor, I have a copy of the hearings on the Judiciary Appropriation Bill for 1945. I know the Court can take judicial notice of the hearings, but I thought, for convenience of the Court and for the expedition of the testimony here that I would like to have this marked as an exhibit. I was going to offer it for your Honor's use.

The Court: I don't believe that we would want to
31 encumber the record with that. If you wish to quote from that in your argument, that you can do in your brief but to have the whole thing in the record, would encumber the record with a lot of irrelevant matter.

Mr. Crampton: That is true. But, they are hard to find, and I thought it would be helpful for the Court. May I have it marked for identification?

The Court: Let it be marked for identification as Petitioner's Exhibit number 4.

(The document referred to was marked Petitioner's Exhibit Number 4 for identification.)

Mr. Crampton: Mr. Whitehurst, please.

Whereupon, **Elmore Whitehurst**, was called as a witness on behalf of the Petitioner, and, having been first duly sworn, was examined and testified as follows:

Direct examination.

By Mr. Crampton:

Q. What is your occupation? A. I am an assistant director of the Administrative Office of the United States Courts.

Q. How long have you held that position? A. Since the office was established on November 6, 1939.

Q. Will you tell us briefly what function your office
32 has in connection with the territorial courts of Alaska? A. We fix the salaries of the supporting personnel at those courts and we handle their budget matters in as many respects as we do the budgetary matters of the courts in the 48 states.

Q. I hand you an exhibit, Petitioner's Exhibit number 4 for identification, and invite your attention to the first page of that exhibit and I will ask you if you are the same Mr. Whitehurst that is referred to as appearing at that hearing.
A. Yes.

Q. Did you work with Mr. Chandler throughout the hearings referred to in that exhibit? A. I did, yes.

Q. I wish you would look at page 79 of Petitioner's Exhibit number 4, for identification, approximately in the middle of the page, the report speaks of "salary differential for higher living costs outside the United States". At that point Congressman O'Neill asked how many employees were involved. The answer that was given included six in Alaska, and I will ask you if the position held by the petitioner, Mr. M. E. S. Brunelle, as Clerk of the United States District Court for the Territory of Alaska, Third Division, was one of the positions included in the six referred to in that answer. A. It is, yes.

Q. In the same exhibit, Mr. Whitehurst, on page
33 76, the second line from the bottom, and again on page 80, about 13 lines from the bottom, it speaks of the amount of \$14,920 as "salary differential for higher living costs outside the United States."

Mr. Stoddard: Objection, you Honor. This is going into a matter that is all included in the legislative history of the Appropriation Act. I don't see that it is a matter to be shown in evidence. The petitioner can argue all this matter in briefs.

Mr. Crampton: If your Honor please, I have not asked the question yet.

The Court: Let us get the question.

By Mr. Crampton:

Q. I would like to ask you if that amount of \$14,920 was the amount requested by your office for the purpose that I have quoted?

Mr. Stoddard: The best evidence of what was requested was either the budget estimates and requests and the legislative history presented to the Houses of Congress.

The Court: Does the best evidence disclose whether it was or not? That is, is there anything in the hearing that discloses, aside from the testimony this man could give, as to what the purpose of this \$14,000 was?

Mr. Stoddard: The language of this hearing we are speaking from, that we are testifying from, says
34 what it was for and it is based upon some figures that they presented to the Committee. My point is that this is purely a matter that is contained in the legislative history of the Appropriation Act.

The Court: What is your contention on that, Mr. Crampton? Are you bringing out by this answer matters that are in that report or does the report itself designate what this \$14,000 is for?

Mr. Crampton: Your Honor, I would say that in the two places I referred to, it speaks of \$14,920 as the salary differential for higher living costs.

The Court: Then, why ask him?

Mr. Crampton: It seems to me it is a little ambiguous. I merely want to show by him that that was the amount requested and finally appropriated, without tracing it through the laborious reports and budget supplements.

The Court: I cannot see that—it would not be prejudicial to have it read.

The Witness: Yes.

By Mr. Crampton:

Q. In order to save searching of various committee reports, can you tell us whether or not that amount was finally appropriated by Congress for that purpose? A. It

was incorporated in the appropriation for salaries of clerks from which these payments were made.

35 Q. I hand you a copy of Public Law 354 and invite your attention to page 25 of that law and ask you if you will tell me which amount that was included in. A. It was included in this appropriation reading, "Salaries of clerks of courts for the United States Circuit Court of Appeals and United States District Courts, their deputies and other assistants, \$2,895,000."

Q. After receiving this appropriation what procedure did your office follow with respect to disbursements of that money? A. We wrote a letter of authorization, which authorized the Marshals to disburse the money.

Q. Did you write such a letter to Mr. Brunelle, this petitioner? A. Yes.

Q. Do you have a copy of it with you? A. Yes.

Mr. Crampton: At this time I offer in evidence as Petitioner's Exhibit number 5 a copy of a letter which the witness has identified.

The Witness: May I call you attention to one thing in that letter? I don't think it is important but I found that we made a typographical error leaving out the word "Courts". We supplied the word "Courts" and put it in brackets so that it would be clear. That is approximately next to the last line.

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Mr. Stoddard: No objection.

The Court: Let it be received.

(The document referred to was marked Petitioner's Exhibit 5 and received in evidence.)

By Mr. Crampton.

Q. Will you tell us, on Petitioner's Exhibit number 5, which of those amounts was paid from the appropriation of \$14,920 to be disbursed? A. That would be the differential of \$1,100; the whole payment came out of one appropriation.

Mr. Crampton: I believe at this time counsel for the Government will agree that \$1,182.59 for 1945 and \$1,285.65

for 1946 were treated the same, your Honor, as the \$1,100 in Petitioner's Exhibit number 5, as far as the Government accounting was concerned.

Mr. Stoddard: Government counsel so agrees.

The Court: All right.

By Mr. Crampton:

Q. Will you tell the Court how your office determined the amount of 25 per cent which is what this differential figure is and which is the amount that you requested from Congress as shown on Petitioner's Exhibit number 4, for identification? A. We took the same amount which
37 was being authorized by the agents in the Executive Branch of the Government for their employees in the territories.

Q. I hand you Petitioner's Exhibit number 3 and I will ask you if Petitioner's Exhibit number 3 is the same document that is referred to on page 67 of Petitioner's Exhibit number 4, for identification, approximately lines 15 to 16. A. That is correct, yes.

Q. Then, am I correct in saying that it is for purposes of your office, this differential your office similarly adopted the 25 per cent that was shown on Exhibit number 3 as being allowed the other governmental agencies?

Mr. Stoddard: I object to the question. It is leading and suggests an answer, your Honor.

Mr. Crampton: I believe he had testified in substance that, your Honor. I just wanted to be sure the record was clear.

The Court: If you would premise your question by "is it or is it not true" or "state whether or not", you would take the leading character of the question away.

Mr. Crampton: All right.

By Mr. Crampton:

Q. Will you state whether or not it is true that your office did follow and did adopt in this instance the 25 per cent that was agreed to by other government agen-

38 cies, as shown in Petitioner's Exhibit 3? A. Yes, we followed that.

Q. So far we have covered the appropriation for the government's fiscal year 1945. Will you state what the situation was as to the fiscal year 1946? A. It was the same.

Q. You had the same type of additional appropriation for the 25 per cent item? A. Yes.

Q. Would that be true in the fiscal year 1947 or at least the first six months of that year? A. That is correct.

Mr. Crampton: You may cross examine.

Cross examination.

By Mr. Stoddard:

Q. You attended these hearings, I believe you testified, with Mr. Chandler? A. I did, yes.

Q. Who is Mr. Chandler? A. He is the Director of the Administrative Office of the United States Courts.

Q. Nothing you have said here is in any way inconsistent with anything that Mr. Chandler had to say before the respective committees of Congress in regard to this, is that right? A. Not as far as I know.

Q. In other words, anything that is contained in
39 the reports of the committee hearings as reported is accurate and describes the requirement of the Administrative Office of the United States Courts in respect to these salaries and your budget requirements, is that correct?

Mr. Crampton: May we have that question read again, please?

Mr. Stoddard: I will withdraw the question and state it again, if you like.

By Mr. Stoddard:

Q. My question is whether the testimony given by Mr. Chandler before the respective committees of Congress, in your opinion, is entirely accurate in respect to these salary differential budget requests. A. Oh, yes, indeed.

Q. In Petitioner's Exhibit number 4, for identification, there is reference to the policy agreement entered into by and between various establishments and departments and independent establishments of the Federal Government and that it states that they are joining in a cooperative move to establish and follow a government-wide policy in that important matter. Now, is it not true that the various departments and independent establishments were requested to study that agreement and to indicate by returning a letter or in some fashion that they were signatories
 40 to the agreement; that they were going to take part in it and be bound by it? A. I don't know whether that is true or not.

Q. Do you know whether the Administrative Office of the United States Courts did sign the agreement? A. To the best of my knowledge it did not.

Mr. Stoddard: I do not have any further questions.

The Court: Any more direct examination?

Mr. Crampton: Not from this witness, your Honor.

The Court: You may stand aside.

(Witness excused.)

Mr. Crampton: May he be excused, if he desires to leave?

The Court: Oh, yes.

Mr. Crampton: Mr. Clement, please.

Whereupon, **Armin G. Clement**, was called as a witness on behalf of the Petitioner, and, having been first duly sworn, was examined and testified as follows:

Direct examination.

By Mr. Crampton:

Q. What is your occupation, Mr. Clement? A. I am attorney in the law office of the Civil Service Commission.

Q. You are here in response to a subpoena, are
 41 you not? A. That is correct.

Q. I will ask you if you were familiar with Executive Order number 9314, referred to in the subpoena? A. Yes, sir, I am.

Q. In that Executive Order, I believe, it is recited that the Civil Service Commission made a recommendation to the President and that the subpoena asked you to produce that recommendation. I will ask you if you are prepared to produce it? A. No, sir, I am not. The reason is that the Commission's records are confidential and under revised 161 are not required to produce such confidential records. But, I was authorized to make notes on the recommendation made to the President and to testify from those notes.

Q. Are you prepared to so testify now? A. Yes, sir.

Q. Will you state the substance of that recommendation?

Mr. Stoddard: I object, your Honor, to any testimony concerning the contents of a document which is not here for examination.

The Court: The document is destroyed—

Mr. Stoddard: This one is not destroyed.

The Court: The witness has testified that it is impossible to bring that into court and I would interpret that to be tantamount to destruction, because certainly a court could not be deprived wholly of knowledge pertaining to that, and this man says that he is authorized to testify. I will have to look into this later on. It is an entirely new question, but I am going to rule on this on the same theory as though the document were destroyed. I am going permit him to testify. I am not sure of my ruling on that at all.

Mr. Stoddard: May I have an exception?

The Court: You may note an exception. Now, I understand that this petitioner has issued a subpoena for this document and the department having custody of the document refused to bring the document into court. It is on that basis that I am going to permit him to testify.

By Mr. Crampton:

Q. Do you want the question read? A. Yes.
(Pending question read.)

The Witness: The recommendation is dated February 2, 1943. In this recommendation the Commission called the President's attention to a Comptroller General decision dated November 16, 1942, in volume 22 at page 491 of his decision, which is referred to by the Commission as a clarifying decision on the subject of salary differential. In that decision the Comptroller General held that the agencies could, in their administrative discretion, pay up to and including a 25 per cent differential on the basis of existing law and he would take an [no] exception if
 43 they made such payments. Following that so-called clarifying decision, first let me say that previous to this decision a variety of plans and methods in paying salary differential had been used. Following that decision the Commission collaborated with various agencies and in that collaboration drew up what is termed as a "policy agreement".

Q. Is that departmental circular number 394? A. Yes, sir. That is the policy agreement that was supplement number 2 of that circular.

Q. Can you state whether or not a copy of this departmental supplemental circular 394, supplement number 2, was sent to the President in the recommendation you testified to? A. I don't know just what that distribution is on those departmental circulars. They go to all the agencies. I am sure of that, but whether they are sent to the office of the President, I do not know.

Q. Am I correct that it did accompany your recommendation? A. Yes, I believe it did.

Q. What was the effect of your recommendation, together with the departmental circular number 394, supplement number 2? A. Following the recommendation, the President issued Executive Order number 9314, which revoked the previous Executive Order 8955, that dealt
 44 with the subject of salary differentials applicable only to the War and Navy Departments for employees under the Classification Act of 1923, as amended, outside the continental limits of the United States.

Q. Did the Civil Service Commission recommend that the Executive Order number 8955 be revoked because of the departmental circular 394? A. Yes, they did. But in addition they said that in order to effect a uniform practice among the agencies and to stabilize employment conditions in the areas affected, they were requesting this and also because during the war it was very difficult to make a check of those positions and the time consumed was too great.

Mr. Crampton: You may cross examine.

Cross examination.

By Mr. Stoddard:

Q. Mr. Clement, in response to a question of counsel for petitioner, you stated that you believe that a copy of the departmental circular number 394 was sent to the President along with this letter in which revocation of a certain Executive Order was recommended? A. Yes.

Q. You do not know for sure? A. I am not positive of that. I would be glad to ascertain that fact and let you know later.

Q. The only purpose of this recommendation was
45 to get rid of a couple of Executive Orders that were
no longer necessary, in view of the broader policy
agreement which included those two agencies, is that not
correct? A. That is correct.

Mr. Stoddard: I have no further questions.

The Court: Any more direct examination?

Mr. Crampton: Yes, sir.

By Mr. Crampton:

Q. Can you review your notes and tell us definitely whether or not a copy of Petitioner's Exhibit No. 3 did accompany your recommendation? I think that is quite material to our showing here. I would like to have a definite answer on that.

The Court: I am wondering if we might have a five minute recess. The witness said he could get that informa-

tion from his files. If you consider that essential to the case, why we would give the witness an opportunity to get that information.

Mr. Crampton: Thank you, your Honor.

The Court: We will take a recess.

(Short recess.)

The Court: Proceed.

By Mr. Crampton:

Q. Mr. Clement, can you now answer the question for us? A. Yes, sir. May I answer it in this way? Do
46 you wish to have me quote the paragraph which is applicable or shall I just answer the question yes or no?

Q. It might be well to have that paragraph. A. I think the paragraph would be more clarifying, if you wish.

Q. Very well. A. "To bring about a higher degree of effective coordination of inter-agencies practices and as a material aid in stabilizing employment conditions in these areas, a policy agreement, which provides a uniform approach to the matter was drafted by administration after conference with the agencies concerned. It was issued as the departmental circular number 394, supplement number 2, a copy is attached. It has received the approval of the War and Navy Departments, as well as a majority of other Federal Agencies employing personnel in these areas which were not covered by Executive Order Number 8955."

Mr. Crampton: That is all, thank you.

The Court: Any further examination?

Mr. Stoddard: I move to strike all the testimony of the witness Clement in regard to the contents and provisions and terms of the letter of transmittal of the Civil Service Commission to the President, on the ground that the best evidence of the contents of the letter is the letter itself.

The Court: I am not sure that this witness would
47 give the same answer that he did in the other matters.

The Witness: If you Honor please, may I make this observation?

The Court: Yes.

The Witness: The letter we have, from which I made my notes, is merely a carbon copy of the original. The original went to the President, so we do not have the original.

The Court: Is this letter also a confidential matter? Are you under any restrictions as to that letter?

The Witness: Yes, sir. I was advised that I could not take the file at all, which includes that letter.

The Court: Do you have the carbon copy of the letter in your possession?

The Witness: No, it is in the file, it is a part of the file.

Mr. Crampton: The letter and the recommendation are the same thing, is that correct, Mr. Clement?

The Witness: It is the letter, that is correct.

The Court: If you tell me that it is impossible for you to deliver the letter in court here, for the same reasons I gave before, I will overrule the objection.

The Witness: It is impossible, yes, sir.

The Court: It is a most unusual situation, but the rule, as I understand it, is destroyed, lost or otherwise unavailable.

48 Mr. Stoddard: May I inquire whether the original was subpoenaed from the Office of the President?

Mr. Crampton: Your Honor, I would like to say this: I don't believe the Government Counsel is in any position to make the objection. We have asked for a document and we have not received it.

The Court: And that was, of course, a matter that was in the back of my head. One department saying they won't comply—

Mr. Stoddard: May it please the Court, isn't it true that the Executive Branch of the Government is merely obeying a specific statutory provision in this case, is that right?

The Witness: Yes, sir.

Mr. Stoddard: That is not, then, the responsibility of the Executive Branch. That is the responsibility of the Legislative Branch of the Government.

The Court: I am not criticizing you for doing your duty and I am not criticizing the witness for doing his duty, but the cold fact is that one branch of the Government here is refusing to deliver evidence to the Court and the representative of another branch is objecting to the contents of those documents on the ground that they are not delivered in court. If that were true, the Government could just simply say that they would not permit any case of
49 this kind to be proved against them, or words to that effect. So, until I have authority to the contrary, I am going to permit the testimony to stand as it is.

Mr. Crampton: I did want to ask if it would not be helpful, and I would like to offer in evidence now, Petitioner's Exhibit number 4. It seems to me it is so tied up that it would be material.

The Court: You can quote from that just as fully as you want to, and Mr. Stoddard can quote from it just as fully as he wants to and if there is any conflict between you two, then I can get a copy of the exhibit from the library here to resolve that conflict and unless there is a conflict, there is no need of having that in evidence. It would probably be a convenience in the event there is a conflict as to what is in the exhibit, but until it is, we will not put it in.

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Findings of Fact and Opinion.

15 T. C. No. 100

THE TAX COURT OF THE UNITED STATES

M. E. S. BRUNELLE, *Petitioner* v. COMMISSIONER OF
INTERNAL REVENUE, *Respondent*.

Docket No. 20780. Promulgated November 30, 1950.

INCOME — EXEMPTIONS — COST-OF-LIVING ALLOWANCE —
ALASKA COURT CLERK—SECTION 116(j).—Increase in the

basic salary of a District Court Clerk in Alaska to offset increased living costs is not exempt from tax under section 116(j).

Scott P. Crampton, Esq., for the petitioner.

Sanford M. Stoddard, Esq., for the respondent.

The Commissioner determined deficiencies in income tax of \$305.37 for 1945 and \$316.92 for 1946. The only issue for decision is whether \$1,182.59 for 1945 and \$1,385.65 for 1946 is exempt from tax as a cost-of-living allowance under section 116(j).

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FINDINGS OF FACT.

The individual returns of the petitioner for the taxable years were filed with the collector of internal revenue for the district of Washington.

The petitioner resided in Anchorage, Alaska, during the two taxable years. He was employed there by the Government of the United States as a Clerk of the United States District Court for the Territory of Alaska.

The Territory of Alaska is "outside continental United States" as that phrase is used in section 116(j) of the Internal Revenue Code.

Certain departments and independent establishments of the government were paying some of their employees recruited in the United States but working outside of the territorial limits of the United States a salary differential based upon high living costs at the place of employment. The Administrative Office of the United States Courts asked Congress to increase its appropriation so that it could pay court employees serving outside the territorial limits of the United States an additional 25 per cent of their base salaries.

The petitioner received a letter dated July 1, 1944, from the Administrative Office of the United States Courts, which was as follows:

"The Appropriation Act for the fiscal year 1945 includes funds for the purpose of granting a 25 per cent increase

in the basic salary of the clerks and deputy clerks in offices outside the continental United States as a differential for increased living costs. We are, therefore, glad to authorize the increase in your salary effective July 1, 1944, as follows:

Name	Basic Salary	Differential	Additional Compensation Pursuant to War Overtime Pay Act of 1943	Total
M. E. S. Brunelle	\$4,400	\$1,100	\$435	\$5,935

70 "This letter or a copy thereof filed with the United States marshal will be his authority to pay the compensation as above set forth from the appropriation 'Salaries of Clerks, United States Courts.'

"The differential for increased cost of living above specified shall terminal on such date as the Director of the Administrative Office of the United States [Courts] may prescribe."

The petitioner, as Clerk of the United States District Court of the Territory of Alaska, Third Division, was paid \$6,275.76 by the Administrative Office of the United States Courts in 1945. Included in that amount was \$1,182.59, computed upon his base salary and paid from funds appropriated by Congress through the Judiciary Appropriation Act of 1945 for "salaries".

He was likewise paid \$7,073.17 in 1946. Included in that total was \$1,385.65, computed upon his base salary and paid from funds appropriated by Congress through the Judiciary Appropriation Act of 1946 for "salaries".

The cost of living in Alaska in 1945 and 1946 was not less than 40 per cent higher than the cost of living in the United States in those years.

The petitioner, had he been transferred to a post within the United States or the District of Columbia, would not have been entitled to receive any part of the \$1,182.59 or of the \$1,385.65, mentioned above, attributable to services subsequent to the effective date of his transfer.

The petitioner, on his return for 1945, excluded the \$1,182.59 from net income and on his return for 1946 excluded the \$1,385.65 from net income.

The Commissioner, in determining the deficiencies, included those amounts in income and explained that section 116(j) of the Internal Revenue Code "does not authorize exclusion from gross income of the 25% differential in pay allowed civilian employees of the Federal Government for service in Alaska. As stated in GCM 24162 RIB 71 #13 dated July 11, 1944, this additional payment does not constitute a cost of living allowance, but is an increased compensation given to induce federal employees to accept hazardous or isolated posts and as such is taxable in full."

The stipulation of facts is incorporated herein by this reference.

OPINION

MURDOCK, *Judge*: Section 116(j) of the Internal Revenue Code was added by section 125(a) of the Revenue Act of 1943. It provides that there shall be excluded from gross income and exempt from tax under Chapter 1:

"(j) In the case of a clerk or employee in the Foreign Service of the United States, amounts received as cost-of-living allowances under authority of section 3, as amended, of the Act of February 23, 1931; and in the case of an ambassador, minister, diplomatic, consular, or Foreign Service officer, amounts received as post allowances under the authority of section 12, as amended and renumbered, of the Act of May 24, 1924; and in the case of other civilian officers or employees of the Government of the United States stationed outside continental United States, amounts received as cost-of-living allowances in accordance with regulations approved by the President."

It has been stipulated that the petitioner was a civilian officer or employee of the Government of the United States stationed outside continental United States. The question is whether the amounts here in question were "amounts

received as cost-of-living allowances in accordance with regulations approved by the President." The parties present the question as a novel one.

The addition of (j) to section 116 was due to a Senate Amendment. The Report of the Committee on Finance on the Revenue Bill of 1943, Report No. 627, 78th Congress, 1st Session, at page 24, contains the following with reference to the new provision:

72 "COST-OF-LIVING ALLOWANCES FOR FEDERAL
EMPLOYEES IN FOREIGN SERVICE

"The committee bill provides a new subsection to section 116 of the Internal Revenue Code to exempt from gross income the cost-of-living allowances granted personnel of the Government assigned for foreign duty.

"Relief is essential to Government personnel stationed in foreign countries who are having a very difficult time and who are reported to be experiencing in the face of rapidly rising living costs a diminution from 22 to 59 percent of the individual amounts it is now possible to provide personnel to assist in meeting official requirements. Under present regulations inclusion of these allowances is required and the income tax thus nullifies in large measure the efficacy of the allowances to meet official expenses incurred by personnel on foreign assignment, and granted in order to meet official requirements.

"The personnel of the Government do not choose the posts to which they are assigned, and they have no control over the costs which there are experienced. They are sent to the posts because highly important duties of the Government must there be accomplished. Payment of allowances to meet the extra costs of living at individual posts is indistinguishable from the payment of allowances to defray the expenses of operation of the establishment, the official entertainment which is necessarily undertaken, the travel personnel is ordered to perform or the rental paid for quarters appropriate to house essential activities.

"The Secretary of State has reported that at posts in the countries now associated with us in common war against the enemy and in those neutral states of supreme importance to us where the Foreign Service is performing a vitally important part of the Nation's war effort, the cost of living continues to mount higher and higher and the financial difficulties of our officers and employees grow progressively worse, threatening the efficiency and morale of this important group of personnel. The Department has neither the authority nor the funds to compensate such personnel for the extra burden which falls upon them by reason of the tax levied on cost of living allowances. The situation is acute and as the allowances are to meet official needs as distinguished from personal requirements, the exclusion of such allowances from tax consideration for this class of personnel is in the public interests."

The Commissioner argues from the above report and from various statutes which he says authorize "cost-of-living allowances", that the payments here in question were not of the kind which Congress intended to exempt; Congress intended to grant the exemption to assist personnel in meeting official requirements at posts to which they

73 have been sent; the petitioner was merely given additional salary because living costs in Alaska were high; and that part of his salary should not be exempt any more than any other part of his salary. There is no showing that the petitioner was sent to any post or that he had to operate any establishment involving official entertainment or anything of the kind.

Section 3, as amended, of the Act of February 23, 1931, referred to in section 116(j) authorizes the Secretary of State "at posts where in his judgment it is required by the public interests for the purpose of meeting the unusual or excessive costs of living ascertained by him to exist, to grant compensation to clerks assigned there in addition to the basic rates herein specified."

Section 12, as amended and renumbered, of the Act of May 24, 1924, referred to in section 116(j), authorizes the

Secretary of State to grant "at all posts allowances for living quarters, heat, light, fuel, gas, and electricity, and at all posts where, in his judgment, it is required by the public interests for the purposes of meeting unusual or excessive costs of living ascertained by him to exist, to grant post allowances to clerks * * * and other employees of the Foreign Service."

Section 901(2) of the Foreign Service Act of 1946 authorizes the Secretary of State to grant to any officer or employee of the Service who is a citizen of the United States cost of living allowances whenever the Secretary shall determine, *inter alia*, that the cost of living at a post abroad is proportionately so high that an allowance is necessary to enable an officer or employee of the service at such post to carry on his work efficiently.

The legislative history of section 116(j), and the words of the statutes referred to above, give considerable support to the contention of the Commissioner that Congress did not intend to exempt mere salary increases but
74 only a limited class of payments that had a close tie-in with the efficient performance of official duties or requirements. Furthermore, payments, to be exempt under the latter part of section 116(j), must be "in accordance with regulations approved by the President." The petitioner has been unable to point to any regulation approved by the President which in any way relates to the payments here in question. The Court is not aware of the existence of any such regulation. The record does not show that there is any error in the determination of the Commissioner.

Reviewed by the Court.

Decision will be entered for the respondent.

• • • • •

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Decision.

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated November 30, 1950, it is

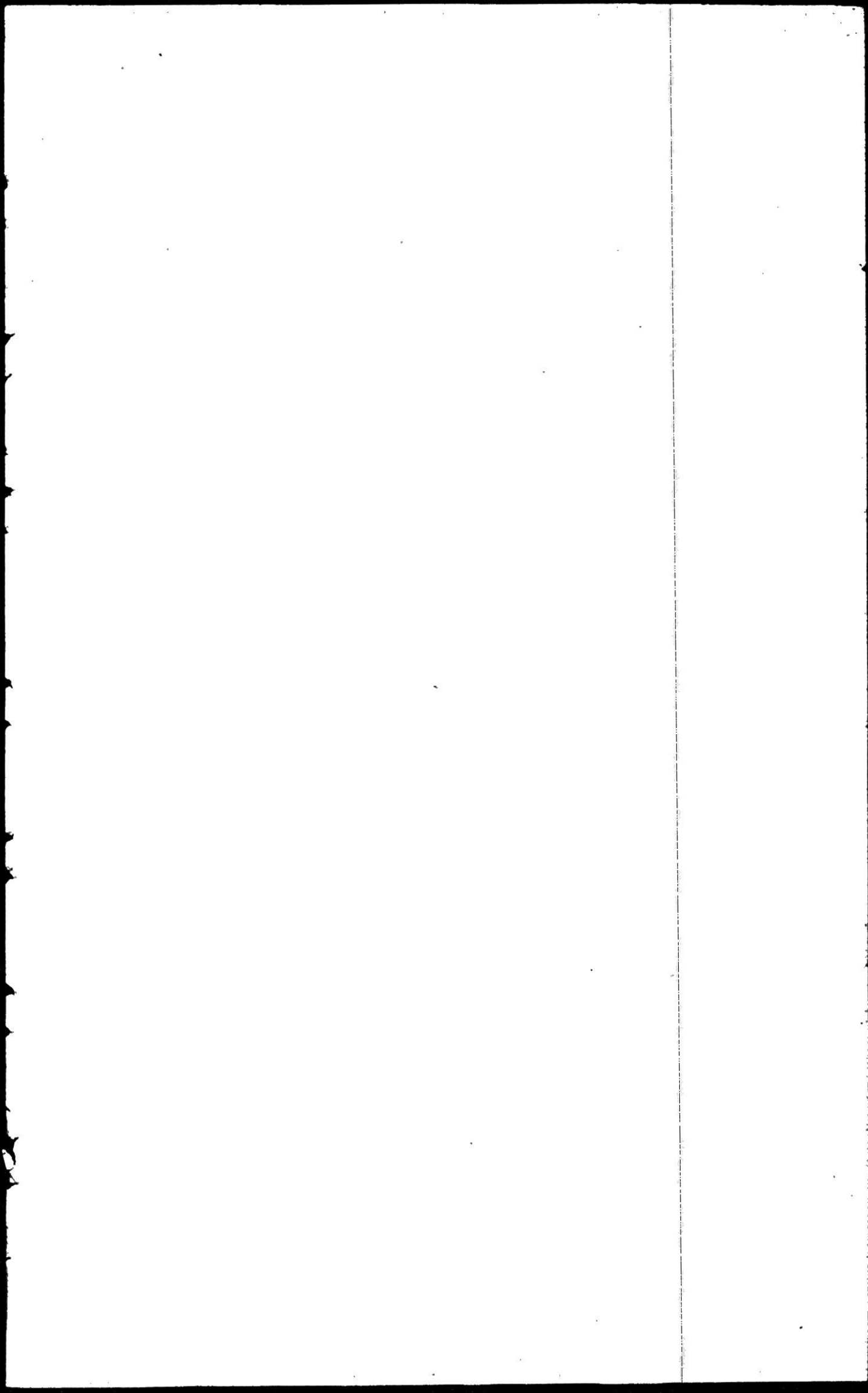
ORDERED AND DECIDED: That there are deficiencies in income tax of \$305.37 for the year 1945, and \$316.92 for the year 1946.

Enter:

Entered—Dec 5, 1950

/s/ JOHN W. KERN,
Judge.

* * * * *



No. 10,983

IN THE
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

M. E. S. BRUNELLE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
ROBERT N. ANDERSON,
GEORGE D. WEBSTER,
Special Assistants to the Attorney General.

*United States Court of Appeals
For the
District of Columbia Circuit*

FILED MAY 28 1931

Joseph W. Stewart

CLERK

STATEMENT OF QUESTION PRESENTED

The question is whether the Tax Court correctly held that the amounts received by taxpayer, a clerk of the United States District Court for the Territory of Alaska, as a 25 percent increase in basic salary during the taxable years involved, constituted income to the taxpayer, or whether the amounts are exempt under Section 116 (j) of the Internal Revenue Code as cost-of-living allowances received in accordance with Regulations approved by the President.

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IN THE
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FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 10,983

M. E. S. BRUNELLE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES*

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Tax Court (R. 19-25)¹ is reported at 15 T. C. 766.

JURISDICTION

This appeal involves deficiencies in federal income tax for the years 1945 and 1946 in the respective amounts of \$305.37 and \$316.92. (R. 26.) The appeal is taken from the decision of the Tax Court entered December 5, 1950. (R. 26.) The case is brought to this Court by petition for review filed March 2, 1951 (R. 3), pursuant to the provisions

¹ Record references are to the Appendix to the taxpayer's brief.

of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the Tax Court correctly held that the amounts received by taxpayer, a clerk of the United States District Court for the Territory of Alaska, as a 25% increase in basic salary during the taxable years involved, constituted income to the taxpayer, or whether the amounts are exempt under Section 116(j) of the Internal Revenue Code as cost-of-living allowances received in accordance with Regulations approved by the President.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 116. EXCLUSIONS FROM GROSS INCOME.

In addition to the items specified in section 22(b), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * *

(j) [added by Sec. 125, Revenue Act of 1943, c. 63, 58 Stat. 21]. In the case of a clerk or employee in the Foreign Service of the United States, amounts received as cost-of-living allowances under authority of section 3, as amended, of the Act of February 23, 1931; and in the case of an ambassador, minister, diplomatic, consular, or Foreign Service officer, amounts received as post allowances under the authority of section 12, as amended and renumbered, of the Act of May 24, 1924; and in the case of other civilian officers or employees of the Government of the United States sta-

tioned outside continental United States, amounts received as cost-of-living allowances in accordance with regulations approved by the President.

* * * * *

(26 U.S.C. 1946 ed., Sec. 116.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.116-4 [added by T.D. 5367, 1944 Cum. Bull. 267]. *Exclusion of certain cost-of-living allowances.*—For taxable years beginning after December 31, 1942, certain cost-of-living allowances and post allowances of Government civilian personnel stationed outside continental United States are, by the provisions of section 116(j), excluded from gross income. Cost-of-living allowances and post allowances, excluded from gross income pursuant to the provisions of section 116(j), shall be considered as retaining their characteristics under the subsection notwithstanding any possible combination thereof with any other allowance, such as a quarters allowance, as, for example, in a "living and quarters allowance," whether or not such other allowance is excluded from gross income.

STATEMENT

The Tax Court found the following facts (R. 20-22):

The taxpayer resided in Anchorage, Alaska, during the two taxable years. He was employed there by the Government of the United States as a clerk of the United States District Court for the Territory of Alaska. (R. 20.)

The Territory of Alaska is "outside continental United States" as that phrase is used in Section 116(j) of the Internal Revenue Code. (R. 20.)

Certain departments and independent establishments of the Government were paying some of their employees recruited in the United States but working outside of the territorial limits of the United States a salary differential based upon high living costs at the place of employment. The Administrative Office of the United States Courts asked Congress to increase its appropriation so that it could pay court employees serving outside the territorial limits of the

United States an additional 25% of their base salaries. (R. 20.)

The taxpayer received a letter dated July 1, 1944, from the Administrative Office of the United States Courts, which was as follows (R. 20-21):

The Appropriation Act for the fiscal year 1945 includes funds for the purpose of granting a 25 per cent increase in the basic salary of the clerks and deputy clerks in offices outside the continental United States as a differential for increased living costs. We are, therefore, glad to authorize the increase in your salary effective July 1, 1944, as follows:

Name	Salary	Differential	Additional Compensation Pursuant to War Overtime Pay Act of 1943	Total
M. E. S. Brunelle	\$4,400	\$1,100	\$435	\$5,939

This letter or a copy thereof filed with the United States marshal will be his authority to pay the compensation as above set forth from the appropriation "Salaries of Clerks, United States Courts."

The differential for increased cost of living above specified shall terminate on such date as the Director of the Administrative Office of the United States [Courts] may prescribe.

The taxpayer, as clerk of the United States District Court of the Territory of Alaska, Third Division, was paid \$6,275.76 by the Administrative Office of the United States Courts in 1945. Included in that amount was \$1,182.59, computed upon his base salary and paid from funds appropriated by Congress through the Judiciary Appropriation Act of 1945 for "salaries." (R. 21.)

He was likewise paid \$7,073.17 in 1946. Included in that total was \$1,385.65, computed upon his base salary and paid from funds appropriated by Congress through the Judiciary Appropriation Act of 1946 for "salaries." (R. 21.)

The cost of living in Alaska in 1945 and 1946 was not less than 40% higher than the cost of living in the United States in those years. (R. 21.)

The taxpayer, on his return for 1945, excluded the \$1,182.59 from net income and on his return for 1946 excluded the \$1,385.65 from net income. (R. 22.)

The Commissioner disallowed these deductions (R. 22), and the Tax Court sustained the determination of the Commissioner, holding that the taxpayer's 25% increase in basic salary was not exempt from the federal income tax by reason of Section 116(j) of the Internal Revenue Code (R. 25). The present appeal followed.

SUMMARY OF ARGUMENT

This case involves the question as to whether or not certain payments received by the taxpayer as a clerk of the United States District Court for the Territory of Alaska, which were classified as differentials, are exempt from the federal income tax by reason of Section 116(j) of the Code which permits the exclusion of certain cost-of-living allowances. It seems clear that the Tax Court correctly held that the taxpayer was not entitled to exclude the payments.

In the first place, the legislative history of the statutory provision indicates that Congress intended to grant the exemption to assist personnel in meeting official requirements incurred by them in behalf of the Government. This clearly was not that kind of payment. Further, the appropriation acts which provided for these payments included them under the general heading "Miscellaneous Items of Expense" and the subheading "Salaries of Clerks, United States Courts." The measuring rod was the base salary and not some specific sum which is the usual case with allowances.

The hearings on the appropriation acts involved herein indicate that the Administrator of the Office of the United States Courts could have made this addition to salary, if he had sufficient appropriation, since it was within his authority to increase the salary of those stationed outside the continental limits. He was requesting Congress not for the payment of allowances but for sufficient appropriation to pay an increased salary.

There is no substance or merit to the arguments of the

taxpayer to the effect that these payments (assuming they did constitute cost-of-living allowances) were approved by regulations issued by the President.

ARGUMENT

The Tax Court Correctly Held That the Amounts Received by the Taxpayer, a Clerk of the United States District Court for the Territory of Alaska, During the Years 1945 and 1946, Were Not Properly Excludible from Gross Income under Section 116(j) of the Internal Revenue Code

The taxpayer during the taxable years involved was a clerk of the United States District Court for the Territory of Alaska. In each of those years, 1945 and 1946, he received certain amounts classified as salary differentials. (R. 20.) This differential was paid from funds appropriated by Congress in the Judiciary Appropriation Act of 1945, c. 277, 58 Stat. 334, and the Judiciary Appropriation Act of 1946, c. 129, 59 Stat. 196. (R. 21.) The taxpayer argues that these amounts are properly excludible from gross income under Section 116(j) of the Internal Revenue Code, *supra*, and Section 29.1116-4 of Treasury Regulations 111, *supra*, as cost-of-living allowances received in accordance with Regulations approved by the President. Contrariwise, the Commissioner's contention is that these amounts are mere differentials in pay and compensatory in nature; therefore, they are includible in gross income under Section 22(a) of the Internal Revenue Code, *supra*.

A. The controlling principles of law.

Section 116(j) of the Code was enacted by Section 125 of the Revenue Act of 1943, c. 63, 58 Stat. 21. It excludes from gross income (1) amounts received as cost-of-living allowances by clerks and employees in the Foreign Service of the United States, (2) amounts received as post allowances by ambassadors, ministers, diplomats, consular, or Foreign Service officers, and (3) amounts received as cost-of-living allowances by other civilian officers or employees of the United States Government stationed outside the continental United States, in accordance with Regulations approved by

the President. The instant proceedings present the question as to whether the amounts received by the taxpayer here in issue fall within this last mentioned classification.²

The intention of the Congress in exempting such cost-of-living allowances should initially be noted. The Senate Finance Committee stated at the time the provision was included in the Revenue Act of 1943 (S. Rep. No. 627, 78th Cong., 1st Sess., p. 24 (1944 Cum. Bull. 973, 992)):³

The committee bill provides a new subsection to section 116 of the Internal Revenue Code to exempt from gross income the cost-of-living allowances granted personnel of the Government assigned for foreign duty.

Relief is essential to Government personnel stationed in foreign countries who are having a very difficult time and who are reported to be experiencing in the face of rapidly rising living costs a diminution from 22 to 59 per cent of the individual amounts it is now possible to provide personnel to assist in meeting official requirements. Under present regulations inclusion of these allowances is required and the income tax thus nullifies in large measure the efficacy of the allowances to meet official expenses incurred by personnel on foreign assignment, and granted in order to meet official requirements.

The personnel of the Government do not choose the posts to which they are assigned, and they have no control over the costs which there are experienced. They are sent to the posts because highly important duties of the Government must there be accomplished. Payment of allowances to meet the extra costs of living at individual posts is indistinguishable from the payment of allowances to defray the expenses of operation of the establishment, the official entertainment which is necessarily undertaken, the travel personnel is ordered to perform or the rental paid for quarters appropriate to house essential activities.

² It was stipulated that the taxpayer was a civilian officer or employee of the United States stationed outside the continental limits. (R. 22.)

³ There is no suggestion in this report that this statement deals only with the first two classifications of Section 116(j) of the Code as argued by the taxpayer. (Br. 14.) This is the complete statement of the Senate Finance Committee on this section of the Revenue Act of 1943.

The Secretary of State has reported that at posts in the countries now associated with us in common war against the enemy and in those neutral states of supreme importance to us where the Foreign Service is performing a vitally important part in the Nation's war effort, the cost of living continues to mount higher and higher and the financial difficulties of our officers and employees grow progressively worse, threatening the efficiency and morale of this important group of personnel. The Department has neither the authority nor the funds to compensate such personnel for the extra burden which falls upon them by reason of the tax levied on cost of living allowances. The situation is acute and as the allowances are to meet official needs as distinguished from personal requirements, the exclusion of such allowances from tax consideration for this class of personnel is in the public interest.

It seems manifest from a reading of this statement that this enactment has reference not to payments as compensation for services rendered but to payments of a non-compensatory character. In other words, *allowance* means precisely what it says—allowance and not salary. Congress intended to grant the exemption to assist personnel in meeting official requirements or needs incurred by them in behalf of the Government. As the Tax Court stated (R. 25) in an opinion reviewed by the court:

The legislative history of section 116(j), and the words of the statutes referred to above, give considerable support to the contention of the Commissioner that Congress did not intend to exempt mere salary increases but only a limited class of payments that had a close tie-in with the efficient performance of official duties or requirements.

This conclusion as to the Congressional intention is buttressed by the position of the third classification referred to above in the Code. It follows the enumeration of "cost-of-living allowances under authority of section 3, as amended, of the Act of February 23, 1931" and of "amounts received as post allowances under the authority of section 12, as amended and renumbered, of the act of May 24, 1924." Moreover, subsection (j) of Section 116 of the Code is fol-

lowed by subsection (k) which authorizes exclusion from gross income of certain amounts received "under the terms of title IX of the Foreign Service Act of 1946," which in turn provides for the various allowances and benefits such as allowances for living quarters, heat, light, fuel, gas and electricity.

The difference between a salary differential payment such as took place in the instant case (R. 21) and a "cost-of-living" allowance as used in the statutory provision involved herein is clearly marked. The difference rests upon whether or not the payment is compensatory or non-compensatory in character. Whether a payment in a given case shall be taxable compensation or a cost-of-living allowance depends upon the intention of the employer, in this situation the United States Government. See *Poorman v. Commissioner*, 131 F. 2d 946 (C. A. 9th); *Botchford v. Commissioner*, 81 F. 2d 914 (C. A. 9th); *Bausch's Estate v. Commissioner*, 186 F. 2d 313 (C. A. 2d).

The Comptroller General of the United States has pointed out (22 Comp. Gen. 491) that the 25% differential base pay is authorized by the long standing administrative practice of his office. The purpose of the differential is to permit the pay of an employee to be adjusted by administrative action to correspond, so far as may be practicable, to the established rates for positions in departmental services in the District of Columbia. The Comptroller General has further held (22 Comp. Gen. 769) that the differential is a part of the employee's base compensation from which retirement deductions are required to be made. This is consistent with the rulings of the Bureau of Internal Revenue (G. C. M. 24162, 1944 Cum. Bull. 266; I. T. 3807, 1946-2 Cum. Bull. 67) that these 25% differentials are compensatory and not cost-of-living allowances.

Relevant also in this connection is the fact that a differential is measured by the employee's salary, and a cost-of-living allowance is usually stated in specific terms, rather than in terms relating to base pay. Certainly, that the salary is the measuring rod of a payment is evidence that such an

amount is compensatory in nature. See *Willkie v. Commissioner*, 127 F. 2d 953 (C. A. 6th), certiorari denied, 317 U. S. 659; *Bausch's Estate v. Commissioner*, *supra*.

A very commonplace example is further illustrative of the distinction involved herein. The flight pay of an officer of the Armed Forces is based on a percentage of income and is includible in gross income as additional compensation; the allowance for rental and food are specifically stated and are cost-of-living items not includible in gross income. See *Jones v. United States*, 60 C. Cls. 552; G. C. M. 12300, XII-2 Cum. Bull. 30 (1933).

B. *The amounts received by the taxpayer in the instant case were not cost-of-living allowances, received in accordance with Regulations issued by the President.*

In the first place, it should be noted that the Judiciary Appropriation Act of 1945, *supra*, and the Judiciary Appropriation Act of 1946, *supra*, appropriated a 25% increase in basic salaries as a *differential* for increased living costs. The funds appropriated in these acts for payment of the amounts here involved for each of the taxable years were appropriated under the general heading "Miscellaneous Items of Expense" and under the subheading "Salaries of Clerks, United States Courts."

Thus, the amounts received by taxpayer were paid as salary and received as salary from funds appropriated by Congress for the payment of salaries and for no other purposes. The use for any other purpose would clearly have been unwarranted.

This appropriation was in accord with the requests of the officers of the Administrative Office of the United States Courts who in appearing before the Congress made requests for a "salary differential." House Hearings on the Judiciary Appropriation Act of 1945, 78th Cong., 2d Sess., p. 76. Also brought out in these hearings by Mr. Chandler, the director of the Administrative Office of the United States Courts, was the fact that he had already been paying a 10% salary differential to the employees of the federal court system stationed outside the continental limits, under

general administrative authority. Hearings, *supra*, p. 68. He specifically stated (p. 68) that the only reason he was asking for a larger appropriation was because he could not pay the 25% without going beyond his appropriation. In other words, to pay a 25% differential, he only needed more money—not further authorization or the approval of the President through Regulations.

Also significant in these hearings is the further testimony of Mr. Chandler (Hearings, *supra*, p. 67-68):

Mr. O'Neal. Are you asking for it all the way through?

Mr. Chandler. I am asking for it in all of the salary appropriations to which it applies. It will come up in the appropriation for clerks' salaries. I do not believe it enters into the appropriation for miscellaneous salaries.

Mr. O'Neal. The one that we have just finished discussing, you did not have such an item?

Mr. Chandler. No.

Mr. O'Neal. Why not? Why do you ask it for one and not the other?

Mr. Chandler. The reason for that is this: That the plan proposed for law clerks and secretaries of judges in itself provides for a substantial increase in compensation for those classes of employees. It was our view that it would be entirely fair to the employees affected, without the allowance of a differential.

In other words, the law clerks and secretaries of judges were to receive salary increases that would better enable them to cope with the cost of living, and the same thing was desired for the clerks of the courts. This further strongly emphasizes the compensatory nature of the payments.⁴

Thus, the instant case simply involves the fact that the taxpayer received more compensation for his work outside the United States than he would have for the same type of

⁴ In view of all of these factors, the taxpayer's argument, that his increase in salary must be considered as a cost-of-living allowance because increased cost of living was a consideration in the passage of the appropriation, has no merit.

work if he had stayed within the continental limits and hence that extra amount is not excludible from gross income.

At this juncture, it should be noted that the taxpayer attempts to equate a salary differential and a cost-of-living allowance. This position is completely untenable and its absurdity is illustrated in taxpayer's argument (Br. 13) that any amount paid, which would not be paid if the taxpayer were in the United States, is an allowance within the meaning of the statute.

The situation in the instant case may be analogized to that in *Marshall v. United States*, 77 F. Supp. 182 (E.D. La.). There the taxpayer, a naval aviator, upon his release from active duty, received certain payments for each year's service. It was held that these payments were not exempt as mustering-out pay under Section 22(b)(14) of the Internal Revenue Code. Such payments were held to be in the nature of bonus awards (compensatory) payable after the termination of service and payable because of the unusual service rendered, whereas mustering-out payments were for the purpose of enabling discharged servicemen to adjust themselves to the status of their peacetime activities.

The final hurdle that the taxpayer must pass is that the payments (even assuming that they are cost-of-living allowances as provided for in the statutory provision) must be made in accordance with regulations approved by the President. No such regulations have been issued, and hence for another reason, the taxpayer has failed to bring himself within the purview of the statute.⁵

However, the taxpayer argues (Br. 15) that such requirement has been met because the President signed the appropriation measure and that a statute takes precedence over a regulation. An appropriation act is nothing more than an authorization for the setting aside or earmarking of certain funds for certain purposes. It does not author-

⁵ In this connection the Tax Court stated (R. 25):

The petitioner has been unable to point to any regulation approved by the President which in any way relates to the payments here in question. The Court is not aware of the existence of any such regulation.

ize payment, which must be made in accordance with other provisions of substantive law and administrative Regulations. Certainly an appropriation act could never serve as a waiver of a requirement of substantive law set forth in a tax exemption statute the terms of which must be strictly met. See *Helvering v. Northwest Steel Mills*, 311 U. S. 46; *United States v. Stewart*, 311 U. S. 60.

The taxpayer's other argument (Br. 15-16) attempting to show that this requirement of the statute has been met is even more difficult to understand. This argument is based on the following sequence of events. After a decision of the Comptroller General (22 Comp. Gen. 432) to the effect that salary differential payments not to exceed 25% of base payments could be made administratively except where by executive order all the provisions of the Classification Act of 1923, c. 265, 42 Stat. 1488, had been extended to the particular field service, the Civil Service Commission worked out with certain Government agencies a voluntary agreement (to which the Administrative Office of the United States Courts was not a party) for the payment of wage differentials. (R. 13-19). To enable the War and Navy Departments to participate in the new arrangement and to effect a uniform practice among the agencies, the Commission recommended revocation of the only Executive Order (Executive Order No. 8955, 6 Fed. Register 6201) that had ever been issued extending the Classification Act to any branch of the field service (War and Navy Departments). Hence, instead of the revocation of Executive Order No. 8955, *supra*, by Executive Order No. 9314, 8 Fed. Register 3279, constituting an approval of a regulation authorizing the payment of cost-of-living allowances, as contended by the taxpayer, it is made evident that the salary differential of the type here under consideration could be paid without the promulgation of a regulation or Presidential approval thereof. No regulation was necessary and none was issued.

Taxpayer's argument (Br. 16) relative to the liberal construction of a relief section is equally without merit. Section 116(j) of the Code is an exemption provision and hence

should be strictly construed. *Pacific Co. v. Johnson*, 285 U. S. 480.

CONCLUSION

The decision of the Tax Court should be affirmed.

Respectfully submitted.

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MAY, 1951.

REPLY BRIEF FOR PETITIONER

IN THE

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 10,983

M. E. S. BRUNELLE, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for Review of the Decision of The Tax Court
of the United States.

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REPLY BRIEF FOR PETITIONER.

In his statement of the case (Br. 3-5) the respondent has set forth only the limited findings of the Tax Court. Petitioner believes that other facts should be considered and these have been stated in his principal brief (pp. 2-6). Apparently respondent has no doubt that these additional facts are accurately stated by petitioner.

REPLY TO THE ARGUMENT FOR RESPONDENT.

Respondent states at the outset of his argument (Br. 6) that the taxpayer claims the amounts involved are properly excludible under Section 116(j) "and Section 29.116-4 of Treasury Regulations 111, *supra.*" Petitioner believes it

important that his position be made clear at the beginning, and for this reason it should be noted that petitioner does not claim that he comes under Section 29.116-4 of the Regulations. *Petitioner claims that there are no regulations dealing with the third subsection of Section 116(j) of the Code* (Pet. Prin. Br. 13-14). In fact, the Treasury Regulations (Resp. Br. 3), as well as the statement in the Senate Report (App. 23-24) ignore the third subsection of Section 116(j). And it is this *third subsection of the statute* that covers the situation presented here.

On page 6 of his brief respondent clearly sets forth the three sections of Section 116(j), and then on page 7 respondent in his footnote disagrees with petitioner's assertion that the Senate Report covers only the first two classifications. Petitioner agrees the quotation is complete and submits that it covers the first two classifications in considerable detail. There is, however, no comment that appears to petitioner to cover the third subsection; respondent certainly points to none.

Respondent next suggests (Br. 9) that the difference between a salary and an allowance

* * * rests upon whether or not the payment is compensatory or non-compensatory in character.

If this test is accepted, respondent is necessarily arguing that petitioner was being "compensated" at one rate for being a clerk in Anchorage but if he performed exactly the same duties in Seattle he was to be "compensated" at a reduced rate. Petitioner submits that a more reasonable analysis would be to say that he was "compensated" at a basic rate for being a clerk and was "reimbursed" for the additional expenses which he incurred by reason of the fact that he had to remain in Alaska.

Respondent also contends that the test depends "upon the intention of the employer, in this situation the United States Government" (Br. 9). Petitioner believes the inten-

tion of the Government to make an "allowance" is clearly shown in the fact that the additional appropriation was sought and granted solely to meet increased living costs in Alaska (Pet. Br. 4-6). To clinch the point it should be remembered that petitioner would lose this additional 25 per cent immediately upon returning to the States, and the Administrative Office of the United States Courts even reserved the right—apparently at will—to discontinue the payment of this additional amount (App. 21). In the light of the facts here presented, it seems of little help to discuss cases which hold that certain bonus payments deducted as expenses by the employers constitute taxable income to the employees (Resp. Br. 9).

A short answer can also be given to the early rulings of the Comptroller General which are discussed next by respondent (Br. 9). As pointed out in petitioner's principal brief (p. 12), the Comptroller General has changed his position since the cited rulings were issued.

The last point made by respondent is that the 25 per cent here involved was computed on petitioner's base salary. But the base salary was only a measure. Petitioner submits that this measure was adopted as a rough convenience to avoid such complications as would result if the measures were the size of the family or some cost of living index. *Willkie v. Commissioner* (Resp. Br. 10), involved a bonus which the employer paid and deducted as an expense. It did not appear that the bonus was in any way intended to reimburse the employee for expenses incurred by him, and the court held that the bonus was income and not a gift.

The example of flight pay which is next urged by respondent is not in point. In such a case the officer, by flying, is performing additional services and of course his pay is compensation. The basic distinction between compensation and an allowance (or reimbursement) is well stated in the case cited by respondent of *Jones v. United States*, 60 C. Cls. 552, 567:

A vast number of Government employees receive traveling expenses and fixed sums in lieu of subsistence when away on Government affairs. Clearly such allowances are for purposes of reimbursement. * * * It is not even suggested that allowances of this character are compensation. In what respect, then, is the allowance of public quarters or commutation of quarters to an Army officer different in character from one intended as reimbursement? *We are quite firmly convinced that not only are they not allowances of a compensatory character but they are not income as well.* (Italics supplied.)

Petitioner submits that the same reasoning applies with like force to his case.

In the second part of his brief respondent contends that "the taxpayer attempts to equate a salary differential and a cost-of-living allowance" (Br. 12). If the matter is to turn on governmental jargon, the language to be construed is "salary differential for higher living costs" (Prin. Br. 11).

Marshall v. United States, cited by respondent (Br. 12), involved a claimed exemption for amounts to which the taxpayer was entitled because of services as a naval aviator. The case is inapposite since the salary statutes there involved and the exemption provisions invoked are all dissimilar.

On page 13 respondent oversimplifies the situation in an effort to show a lack of Presidential approval. The revocation of Executive Order No. 8955, however, was on the recommendation of the Civil Service Commission which had completed its Departmental Circular on the matter (Prin. Br. 3). This circular was necessarily therefore approved—though by indirection—and the Circular was considered to be a regulation by the Comptroller General (23 Comp. Gen. 319, 322).

One final comment appears warranted. While respondent's brief has covered to some extent the various technicalities of the case, it has failed to meet the substance

of the issue. When Congress appropriates additional funds solely because of higher living costs (Prin. Br. 5, 11), which amounts are to be paid in the discretion of an official and only so long as an employee remains outside the United States (App. 21), it would be hard indeed to convince "the man in the street" that the amounts are not an allowance (cf. Prin. Br. 11). As was said in *De Ganay v. Lederer*, 250 U. S. 376, 381:

Unless the contrary appears, statutory words are presumed to be used in their ordinary and usual sense, and with the meaning commonly attributable to them.

Cf. *Old Colony R. Co. v. Commissioner*, 284 U. S. 552, 561.

CONCLUSION.

The substance of the situation is that petitioner was "allowed" an additional amount so long as he remained in Alaska and the Administrative Office continued its payment. Such additional amounts are exempt from tax under Section 116(j) of the Code.

Respectfully submitted,

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